

BEFORE THE
SURFACE TRANSPORTATION BOARD 300044

STB Docket No. EP 761
Hearing on Revenue Adequacy

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Railroad Revenue Adequacy

WRITTEN COMMENTS OF
THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

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**WRITTEN SUBMISSION OF
THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE**

The National Industrial Transportation League (“NITL” or “League”) hereby submits its written submission on the revenue adequacy issues raised in the Notice of Public Hearing (“Notice”) served by the Surface Transportation Board (“STB” or “Board”) on September 12, 2019 in the above-noted proceedings.

The League represents a broad cross-section of American business, united in their need for reliable, efficient and competitive transportation services. Our rail members ship chemicals, petroleum, agricultural products, paper and forest products, and many other commodities using all modes of transportation, including rail. Our members have developed complex supply chains to support their operations. Efficient and competitive rail service, and fair rules and practices related to such service, are critical to maintaining the supply of goods required to meet the demand of American businesses and consumers and to compete effectively with producers around the world.

The Notice indicates that the Board will hold a public hearing on December 12, 2019 on revenue adequacy issues that were raised in the report issued by the Board's Rate Review Task Force ("RRTF"). The RRTF was established in January 2018 to recommend improvements to the existing rate review processes and to propose new rate review methodologies that would be more attuned to the realities of the current transportation world.¹ The RRTF's Report, issued to the Board on April 25, 2019, dealt with a variety of railroad rate review matters. Among them were matters dealing with railroad revenue adequacy, including proposals dealing with the definition of long-term railroad revenue adequacy; a proposed possible rate increase constraint; a proposed change to the Board's bottleneck rules; and a proposed change to the Board's Simplified Stand-Alone Cost Rules for revenue adequate carriers.²

In its September 12 Notice, the Board invited interested persons to provide input on the RRTF's recommendations regarding revenue adequacy. Based on the current financial strength of the freight rail industry, including the large number of Class I railroads who recently and currently have been determined by the Board to be revenue adequate, it is entirely appropriate for the Board to evaluate possible new rate review procedures that would apply to revenue adequate carriers. The League thanks the Board for issuing its Notice of Public Hearing and provides its written submission on each of the RRTF's revenue adequacy proposals below.

A. Definition of Long-Term Revenue Adequacy

In its Report, the RRTF noted that the Board has been directed by statute to assist rail carriers in achieving revenue adequacy, and is required to determine which rail carriers are earning adequate revenues.³ The Report further noted that the Board's annual revenue adequacy

¹ RRTF Report, p. 1.

² RRTF Report, pp. 32-41.

³ RRTF Report, p. 32.

determination is simply a one-year snapshot, and was never intended to identify whether rate relief was available under the long-term revenue adequacy constraint announced in *Coal Rate Guidelines*.⁴ In that decision, the agency noted that revenue adequacy is a “long term” concept, not a single-year snapshot.

With this background, the RRTF indicated that the Board has never announced a working definition of what it means to be long-term revenue adequate, and stated that “the time is ripe for the Board to pronounce a working definition of long-term revenue adequacy. . . .”⁵ The RRTF recommended that the Board measure long-term revenue adequacy “over the length of an entire business cycle,” in order to include the negative effects of a recession. The Task Force’s specific recommendation was to look at the **“shortest period of time, not less than five years, that includes both a year in which a recession began and a year that follows a year in which a recession began.”**⁶ The RRTF Report then set forth the long-term revenue adequacy status of each of the nation’s Class I carriers for each relevant period per year from 2002 through 2017. The data set forth in the RRTF Report thus covered two recessionary periods in 2001 and 2008-2009.

The League believes that the long-term revenue adequacy standard recommended in the RRTF Report is extremely conservative, tending to emphasize the effects of recessions on the finances of the nation’s rail carriers. The RRTF indeed concedes this point, noting that its recommendation “emphasize[s] the significance of recessions. . . .”⁷ The RRTF methodology does this by requiring both the year in which a recession began and a year following a year in

⁴ *Coal Rate Guideline, Nationwide*, 1 I.C.C.2d 520, 536 (1985), *aff’d sub nom. Consol. Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

⁵ RRTF Report, p. 33.

⁶ *Id.* (emphasis in original).

⁷ *Id.*, p. 35.

which a recession began to be included in the analysis (which second year could itself be part of the recessionary period, as it was in 2007-2008), and by focusing on the “shortest” period of time, not less than five years, in which those events occur. Use of the “shortest” period of time again emphasizes the effects of a recession on the finances of the nation’s rail carriers by limiting the years considered. The RRTF indicates that these features will add a “confidence factor” that railroads will achieve and maintain long-term revenue adequacy by emphasizing the effect of recessions on the nation’s rail carriers.⁸ Therefore, if a rail carrier achieves long-term revenue adequacy under the RRTF’s proposed definition, the Board can be certain that a rail carrier is financially sound over the long-term.

Particularly given the conservative nature of the recommended definition of long-term revenue adequacy, the figures in the RRTF Report for the long-term revenue adequacy status of each of the nation’s Class I rail carriers are significant; indeed, eye-opening. Though the average cost of capital in each of these periods from 1998 to 2017 has remained fairly stable,⁹ the average return on investment of all of the nation’s Class I rail has climbed significantly over this period. UP’s average long-term return over this nineteen-year period has more than doubled, from 6.56% to 13.01%. NS’ and BNSF’s average long-term return have increased by about 40% over this period. Even carriers that have not achieved long-term revenue adequacy under the RRTF’s definition have seen a major increase in their returns: CP’s average long-term return has doubled, and CSX’s average long-term return has nearly doubled. Accordingly, the long-term revenue adequacy data included in the RRTF report fully supports the use of a variety of rate and market constraints on such carriers.

⁸ *Id.*

⁹ The average cost of capital in each revenue adequacy test period has ranged from a low of 10.23% (from 1999-2003) to a high of 11.22 % (in 2007-2013).

In addition, it is significant that, once a carrier has achieved long-term revenue adequacy even under the conservative definition proposed by the RRTF, the carrier remains long-term revenue adequate over time. Thus, NS achieved long-term revenue adequacy in 2006, and has remained long-term revenue adequate every single test period since then, through 2017, the most recent year for which data is available. UP and BNSF achieved long-term revenue adequacy in 2012 and 2013 respectively, and they also have maintained that status for every period since then.

The data in the RRTF Report thus indicates two things of major significance. First, the rail industry that the Board oversees in 2019 is night-and-day different from the rail industry that the Congress and the agency faced in 1980 at the time of the Staggers Act and even the industry existing at the time of the ICC Termination Act of 1995. Specifically, the freight rail industry has experienced a financial renaissance since that time and is currently very financially strong. Thus, it is entirely appropriate for the Board to develop new rate review rules that reflect the existing financial state of the Class I railroads, including the achievement by the vast majority of revenue adequacy. Second, the financial trends in the industry and the tendency for carriers to remain long-term revenue adequate after they have achieved that status, strongly indicates that the Board can place constraints on long-term revenue adequate carriers without fearing that the financial status of these carriers will be compromised.

B. Rate Increase Constraint

In its Report, the RRTF described a possible rate increase constraint (RIC) applicable to carriers that are long-term revenue adequate. The proposed constraint identifies the point at which the existing application of differential pricing is enough: carriers at or above that point would be forbidden from increasing non-contract, non-exempt rates by more than the rate of inflation. If a rate is below the threshold, a carrier could raise that rate to the threshold, but not

beyond. The RIC threshold would be determined by calculating an average annual real surplus beyond long-term revenue adequacy and that surplus would be allocated to various commodities. At that point, an increase in differential pricing beyond the RIC threshold would be subject to challenge. A shipper would have to file a complaint, prove that the railroad is market-dominant with respect to the challenged movement(s) and show that the issue movement is non-exempt and non-contract.¹⁰ The rate increase constraint proposed by the RRTF would provide benefits to shippers and would not be unfair to carriers. Certainly, if a carrier is long-term revenue adequate and is market dominant as to a particular movement, there is no reason why that carrier should be permitted to increase such captive rates any further. Indeed, the Rate Increase Constraints identified in the RRTF Report are still financially profitable to carriers, sometimes in the extreme. Specifically, the RRTF Report indicates that, depending upon the commodity, the RIC would apply beginning at no less than a revenue to variable cost ratio of 180% for certain commodities, and for some commodities on certain railroads a constraint would not apply until the revenue to variable cost ratio for a movement would exceed over 600%.¹¹

Although existing rates could not be reduced under this constraint, at least further rate increases would be limited solely to increases in a railroad's cost of service. Under the proposal, it would be relatively simple for a shipper to determine whether its rate was below, at, or above the RIC level, by simply calculating an R/VC for the movement. And, while a shipper would have to file a complaint, the litigation would basically be limited to a determination of market dominance. Thus, while the proposed RIC would not have huge benefits to shippers, since it would only limit future rate increases, shippers would benefit from not have huge litigation or

¹⁰ RRTF Report, pp. 36-37.

¹¹ RRTF Report, p. 38 (R/VC Constraint for chlorine for NS would be 639%).

other costs either. The League believes that the adoption of the proposal by the Board is legally supportable and would offer benefits to some companies in the shipper community.

C. Bottleneck Changes

The third topic for comment set forth in the Board's Ex Parte 761 Notice of Public Hearing was the RRTF's recommendation for suspension of the Board's Bottleneck protections as applied to long-term revenue adequate carriers.¹² In its Report, the RRTF first noted the agency's decisions in its "Bottleneck" cases¹³ which restrict bottleneck relief only to situations where a shipper has made a full-blown competitive access case (which relief has rarely been granted) or where the shipper has obtained a rail contract for the non-bottleneck segment in cases where the origin carrier does not also serve the destination.¹⁴ The RRTF indicated that a change in the Board's policy for long-term revenue adequate carriers could be an "effective" competitive remedy, since it would make it easier to require such carriers to perform a short-haul in order to promote competition for a portion of the movement.¹⁵ In discussing its recommendation, the RRTF analyzed the statutory and legal basis for the Board's Bottleneck decisions, and the legal basis for making a change to that policy for long-term revenue adequate carriers. The League has examined the RRTF's legal analysis and agrees that the Board would be well within its discretion to make such a change. First, the statute on its face provides the Board with a legal basis for limiting a carrier's general routing prerogatives and its long-haul in particular. Specifically, 49 U.S.C. §10705(a)(2)(C) states that "[t]he Board may require a rail carrier to

¹² Ex Parte 761 Notice, p. 3; RRTF Report, pp. 39-41.

¹³ *Central Power & Light Co. v. S. Pac. Transportation Co.*, 1 S.T.B. 1059 (1996), *clarified*, 2 S.T.B. 235 (1997), *aff'd sub nom. MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

¹⁴ RRTF Report, p. 40.

¹⁵ *Id.*

include in a through route substantially less than the entire length of its railroad when...the Board decides that the proposed through route is needed to provide adequate, and more efficient or economic, transportation....” Elimination of the Board’s Bottleneck restrictions in the case of long-term revenue adequate carriers would permit shippers to access rail-to-rail competition for at least a portion of the through route, thus obtaining more “economic” transportation. Shippers would not pursue the alternative routing using a bottleneck rate if the more competitive transportation did not also provide “adequate” service. Thus, removal of Bottleneck restrictions for long-term revenue adequate carriers would meet the express terms of Section 10705(a)(2)(C), by resulting in “adequate” and “economic” rail transportation.

Moreover, the elimination of Bottleneck restrictions for long-term revenue adequate carriers would be consistent with the purpose of the statute and the changes in circumstances underlying the Board’s 1990s Bottleneck decisions. In reviewing the agency’s Bottleneck Decisions, the Eighth Circuit noted that the Board had “grappled with the tension between two competing policies expressed in the Interstate Commerce Act,” namely, the carriers’ broad discretion in setting rates and routes, and regulation of a railroad’s monopoly power.¹⁶ The court also noted that:

the Act protects both shippers and carriers. It guarantees that shippers will receive service at reasonable rates, and it allows carriers to provide service in a manner that achieves revenue adequacy.¹⁷

The court then noted that “in the present case, the Board determined that exploiting bottlenecks by refusing to provide separately challengeable bottleneck rates also assists carriers in achieving revenue adequacy.”¹⁸

¹⁶ *MidAmerican*, 169 F.3d at 1104.

¹⁷ *Id.* at 1106.

¹⁸ *Id.* at 1107.

But the force of this key rationale underlying the Board's Bottleneck decisions and the Eighth Circuit's review of them disappears in the case of long-term revenue adequate carriers. Indeed, in that case, there is no "tension" between the carriers' need for revenue adequacy and the shippers' need for service at competitive rates because the carrier has already achieved revenue adequacy over at least a five-year period (and in the present cases, much more). Thus, the Board is well within its discretion in opening up bottleneck relief for such carriers.

The League strongly supports the RRTF's recommendation for a change in the Board's Bottleneck rules in the case of long-term revenue adequate carriers. In the current situation, the change would allow a shipper to obtain competition over a non-bottleneck segment and would also allow a shipper to challenge a bottleneck rate, at least for three of the nation's seven Class I railroads. Based on present circumstances, this would introduce greater rail competition at least for these three carriers. Of course, if the bottleneck carrier offers an excessive rate over the bottleneck segment, the shipper would still have to challenge that rate before the Board and be able to show that the bottleneck rate is unreasonable. The potential need to litigate the reasonableness of the bottleneck rate is a difficult task that by itself would limit the practical application of the new rule. Yet, by permitting competition over the non-bottleneck segment and by permitting a shipper to bring a reasonableness complaint against a bottleneck rate, fairer and more competitive rates are likely to result, either through negotiation with the bottleneck carrier or through rate reasonableness litigation before the Board.

In supporting the adoption of the RRTF bottleneck recommendation by the Board, the League recognizes that there is a significant limitation to that recommendation: namely, bottleneck relief would apply only to long-term revenue adequate carriers. Currently only three of the nation's seven Class I carriers would qualify as long-term revenue adequate. This leaves

shippers served by nearly sixty percent of the nation's carriers without this competitive access relief. Accordingly, even if the Board were to open up bottleneck rates as recommended by the RRTF, there is still a need for the Board to adopt its proposed competitive switching rules which would apply to all Class I railroads.

On July 27, 2016, the Board granted in part a petition by the League to adopt revised reciprocal switching regulations that had been proposed by the League. The Board proposed its own regulations that would allow a party to seek a reciprocal switching prescription that is either practicable and in the public interest or necessary to provide competitive rail service. See, Ex Parte 711 (Sub-No. 1), *Reciprocal Switching*, decision served July 27, 2016. Interested parties filed comments on the Board's proposal on October 26, 2016 and Reply Comments on January 13, 2017. No action has been taken in Ex Parte 711 (Sub-No 1) since then, although the Board has authorized ex parte meetings with Board members and has yet to set a date to close the record in that docket.

The League strongly urges the Board to take action as recommended by the League in its opening and reply comments submitted in EP 711, in order to provide at least some measure of competitive relief to all of the nation's shippers, whether or not they are served by long-term revenue adequate carriers. The League sees no reason for continued inaction in the reciprocal switching proceeding which has been the subject of extensive briefing and expert testimony, has been pending for more than three years, and was constituted from earlier proceedings that began in 2011.¹⁹ Between 2002 and 2017, the average rate of return for each revenue adequacy test

¹⁹ The Board first initiated a hearing on the state of competition in the railroad industry, and possible policy changes, in June 2011 in its Ex Parte 705 proceeding. The League actively participated in the hearing and subsequently filed its Petition for Rulemaking to Adopt Revised Reciprocal Switching Rules soon after that hearing on July 7, 2011.

period for all of the nation's Class I rail carriers has increased from 6.87% to 10.24%.²⁰ No Class I rail carrier had an average return on investment in the most recent revenue adequacy test period of less than 8.28%.²¹ Clearly, the railroad industry as a whole is financially viable and stable. Accordingly, increasing competitive access through broadened reciprocal switching rules for all Class I carriers is in the public interest.

D. Simplified Stand-Alone Cost (Simplified-SAC) Changes

The final RRTF revenue adequacy recommendation involved a proposed change to Simplified-SAC for long-term revenue adequate carriers. Specifically, the RRTF recommended that the Board reinstate the simplification of Road Property Investment from Simplified-SAC for such carriers, to make the Simplified-SAC process quicker and easier. The RRTF also recommended that Simplified-SAC be eliminated for non-long-term-revenue inadequate carriers, since the process has never been used.

The League believes that the Board should not pursue this recommendation. As pointed out by the RRTF, the Simplified-SAC process has never been used, and the League believes that the proposed change will not cure the problems with Simplified-SAC. The time of the Board

²⁰ RRTF Report, p. 35: 2002 (Revenue Adequacy Test Period 1998-2002): BNSF= 8.30%, CN=8.46%, CP=4.92%, CSX=5.06%, KCS=7.06%, NS=7.72%, UP=6.56%. Average of all equals 6.87%. 2017 (Revenue Adequacy Test Period 2007-2017): BNSF=11.44%, CN=9.49%, CP=8.86%, CSX=9.46%, KCS=8.28%, NS =11.12%, UP=13.01%. Average of all equals 10.24%.

²¹ KCS' return on investment in 2017 (2007-2017 test period) was 8.28%. See footnote 5.

and its staff can be better spent on other recommendations by the RRTF, and in other proceedings.

Respectfully Submitted

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